UNITED STATES BANKRUPTCY COURT

DISTRICT OF HAWAII

In re BOMANI J. KIM, Debtor.	Case No. 99-03303 Chapter 7
Clarence B.S. Choi, Edmund Choy, Geraldine Choy, Charles Decoito, Lisa Decoito, Raymond Hew, Robert K. Idemoto, Jr., Thomas H.D. Kim, Maxine Lum, Imelda Mawae, James K. Mawae III, Kanani Mary Mawae-Idemoto, Duane Nakahashi, Allen Ogata, Mitsue Yang, James Fujimoto, Virginio Lista, Duane Owan, Mitchell Owan, Michael McDonald, James Takamiya, and Gary Hashimoto, Plaintiffs, vs. Bomani J. Kim, Defendant.	Adversary Proceeding No. 00-00004

MEMORANDUM DECISION

I. INTRODUCTION

Defendant Bomani J. Kim (Debtor) filed his chapter 7 bankruptcy petition on August 11, 1999. In this adversary proceeding, the plaintiffs seek a determination that the debt which the Debtor owes them is not dischargeable in bankruptcy by virtue of 11 U.S.C. §523(a)(2) for fraud, 11 U.S.C. §523(a)(4) for fraud or defalcation while acting in a fiduciary capacity, and 11 U.S.C. §523(a)(6) for wilful and malicious injury.

Trial was held on September 23, 2002. At trial, Joy Yanagida, Esq. appeared on behalf of the plaintiffs and Steven Guttman, Esq., and Bradley R. Tamm, Esq., appeared on behalf of the Debtor. Subsequent to trial and on October 24, 2002, an Order Dismissing Counts Four, Five, and Six of Plaintiffs' First Amended Complaint was entered. The remaining issues will be decided in this memorandum decision.

II. BACKGROUND

The plaintiffs[1] are investors in Kailua Estates Partners (KEP) and Kailua Partners (KP). The partnerships were formed for the purpose of purchasing and

[1] The Debtor objects to the standing of two of the plaintiffs, Geraldine Choy and Maxine Lum, to bring this action as the representatives of Milton Choy and Norman Lum, respectively. I will address this objection later and will continue to refer to all of the plaintiffs collectively for convenience.

developing a 30 acre parcel of land on Maui. The Debtor and William G. Weimer (Weimer) acted as promoters, general partners, and managers of the partnerships. The plaintiffs lost $12,500 to $50,000 each.

On November 9, 1998, the Department of Commerce and Consumer Affairs (DCCA) of the State of Hawai'i issued a Preliminary Order to Cease and Desist and Notice of Right to Hearing, which found that the Debtor, the partnerships, and Weimer had "engaged in acts, practices and/or a course of business which operates as fraud or deceit upon persons". The DCCA findings were promulgated by the Commissioner of Securities that performed the investigation and were adopted by the Final Order. On August 9, 1999, a state court entered a "Judgment and Order Compelling Compliance with Final Order of Commissioner of Securities as to Bomani Kim, also known as B.J. Kim," against the Debtor and ordered the Debtor to refund all monies paid plus interest of 10 percent to any investor requesting a rescission and to pay a civil penalty in the amount of $50,000.

The plaintiffs obtained judgments against the Debtor in two cases in Hawai'i state courts. In Choi et alia v. Weimer et alia (Choi), Civil No. 95-0083, Circuit Court of the Second Circuit, State of Hawaii, the plaintiffs obtained an order granting summary judgment against Weimer and the Debtor on the following counts: fraud in the inducement, intentional misrepresentation, breach of

fiduciary duty and constructive trust, fraud, breach of contract, violation of Haw. Rev. Stat. chapter 425 (partnership), securities violations (state law), unjust enrichment, and civil conspiracy. The order adopted all of the DCCA findings. Judgment was entered for $445,418 (principal and interest as of April 1, 1999) with 10 percent interest accruing thereafter. The Debtor was held jointly and severally liable with Weimer and KP.

In Fujimoto et alia v. Weimer et alia (Fujimoto), Civil No. 96-0462, Circuit Court of the Second Circuit, State of Hawaii, the plaintiffs obtained an order for summary judgment against the Debtor, Weimer, and KEP on the following counts: unfair and deceptive trade practices, securities violations, violation of Hawai'i Revised Statutes chapter 425 (partnership), breach of fiduciary duty, intentional and negligent misrepresentation, breach of fiduciary duty (general partners), civil conspiracy, unjust enrichment, and breach of contract. The order also adopted all of the DCCA findings. Judgment was entered for $426,647, and the Debtor was held jointly and severally liable with the other defendants.

The DCCA findings that the state court adopted include:

> 2. Respondents [including the Debtor], at all times material herein, were acting individually and as promoters, general partners, managers, principals, members, and/or agents of Respondents KP and KEP. . . .

. . . .

11. In connection with the offer and sale of securities, Respondents made misrepresentations and/or untrue statements of material fact in violation of the antifraud provisions of the Act, including but not limited to, the following:

. . . .

c. represented that the monies collected from the KEP investors would be used to develop the land and the KP investor monies would purchase the land when nearly all of the monies went to Respondents Weimer and Kim [Debtor];

. . . .

18. Respondents' acts and/or omissions in connection with the foregoing securities constitute or appear to constitute securities fraud . . ., in one or more of the following particulars:

a. Respondents employed devices, schemes, and/or artifices to defraud . . .;

b. Respondents made untrue statements of material facts or omitted to state material facts . . .;

c. Respondents engaged in acts, practices and/or a course of business which operates or would operate as a fraud or deceit upon persons . . . .

III. DISCUSSION

A. The Law of Collateral Estoppel.

Principles of collateral estoppel apply to bankruptcy dischargeability proceedings. Grogan v. Garner, 498 U.S. 279, 285 n. 11 (1991).[2] The preclusive effect of a state court judgment in a subsequent bankruptcy proceeding is determined by the preclusion law of the state in which the judgment was issued. Gayden v. Nourbakhsh (In re Nourbakhsh), 67 F.3d 798, 800 (9th Cir. 1995). Under Hawai'i law, the doctrine of collateral estoppel bars relitigation of an issue where: (1) the issue decided in the prior adjudication is identical to the one presented in the action in question; (2) there is a final judgment on the merits; (3) the issue decided in the prior adjudication was essential to the final judgment; and (4) the party against whom collateral estoppel is asserted was a party or in privity with a party to the prior adjudication. Dorrance v. Lee, 976 P.2d 904 (Haw. 1999).

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[2] The Debtor relies on In re Dennis, 25 F.3d 274 (5th Cir. 1994), for the proposition that collateral estoppel has limited application in section 523 cases. This assertion cannot be squared with the Supreme Court's decision in Grogan or the Ninth Circuit cases cited in this decision. Further, Dennis involved section 523(a)(2)(B), which specifically directs the bankruptcy court to look beyond the label affixed to a state court award and determine whether the award is "actually" in the nature of alimony or support.

The plaintiffs rely on the doctrine of collateral estoppel.[3] The plaintiffs assert that the state court judgments preclude the relitigation of the issues because: (1) the issues are identical; (2) there was a final judgment on the merits; and (3) the party against whom collateral estoppel is asserted was a party or in privity with a party to the prior suit.

The plaintiffs rely on the state court judgments in both Choi and Fujimoto. In Choi, the state court granted summary judgment on the claims of fraud, fraud in the inducement, intentional misrepresentation, and breach of fiduciary duty (constructive fraud of general partners). In Fujimoto, the state court granted summary judgment on the claims of actual and/or constructive fraud, intentional and/or negligent misrepresentation, and breach of fiduciary duty.

The Debtor argues that the plaintiffs have not meet their burden of proof and that the collateral estoppel doctrine fails. The Debtor asserts that the state court judgments do not contain specific factual findings. The Debtor argues that Kelly v. Okoye (In re Kelly), 182 B.R. 255 (B.A.P. 9th Cir. 1995), aff'd, 100 F.3d 110 (9th Cir. 1996), bars the application of collateral estoppel against the Debtor. The Debtor's reliance on Kelly is misplaced. Collateral estoppel failed in

[3] The plaintiffs also rely on res judicata and the Rooker-Feldman doctrine, but collateral estoppel is the applicable doctrine in this case.

Kelly because the issues in the state court proceeding – an action for legal malpractice – were not identical to the issues in the bankruptcy court dischargeability proceeding. "The state court judgment made findings that related to a negligence cause of action and not intentional conduct." Id. at 261. Thus, the doctrine of collateral estoppel was not sufficient to make the plaintiff's case under section 523(a)(6) because the only claim on which the state court entered judgment – negligence – did not establish a "willful and malicious" injury. In this case, as the following section will show, the elements of the claims on which the state court entered judgment overlap the elements of the claims under section 523.

The Debtor argues that collateral estoppel applies only to an issue on which the prior court made an explicit decision. No such requirement exists. The court must presume that the prior judgment was correct and, therefore, that the prior court made all of the findings and conclusions that were needed to support the judgment. See In re Baldwin, 249 F.3d 912, 920 n.6 (9th Cir. 2001). Each of those necessary findings and conclusions has preclusive effect even if the state court did not explicitly state them.

B. Section 523(a)(2)(A)

The plaintiffs allege that the Debtor's debts to the plaintiffs are not dischargeable pursuant to section 523(a)(2)(A) because the state court entered

judgments against the Debtor for fraud and collateral estoppel precludes relitigation of the issue of fraud in this court.

Section 523(a)(2)(A) provides:

> (a) A discharge under section 727 . . . of this title does not discharge an individual debtor from any debt–
>
> . . . .
>
> (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by–
>
> (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition;

The elements of fraud under section 523(a)(2) are: (1) the debtor made a representation; (2) the debtor knew at the time the representation was made that it was false; (3) the debtor made the representation with the intention and purpose of deceiving the creditor; (4) the creditor relied on the representations; and (5) the creditor sustained damage as the proximate result of the representation. In re Ettel, 188 F.3d 1141 (9th Cir. 1999); Apte v. Japra (In re Apte), 96 F.3d 1319 (9th Cir. 1996).

The elements of common law fraud under Hawaii law are identical in substance to those under section 523(a)(2). The elements of fraud under Hawaii law are: (1) the defendant made false representations of material fact; (2) the

defendant intended to induce plaintiff to act; (3) the representations were made with knowledge of, or reckless disregard for, their falsity; and (4) the plaintiff justifiably relied upon those false representations to his detriment. Bulgo v. Munoz, 853 F.2d 710, 716 (9th Cir. 1988).

Under In re Diamond, 285 F.3d 822 (9th Cir. 2002), the state court judgment against the Debtor precludes him from relitigating the issue of fraud under section 523(a)(2)(A). In Diamond, the Court of Appeals for the Ninth Circuit considered whether a state court judgment for fraudulent misrepresentation had issue preclusion effect in a dischargeability proceeding under section 523(a)(2)(A) and 523(a)(6). The court concluded that the reliance element in the state law fraudulent misrepresentation claim was identical to that in the nondischargeability claim under section 523(a)(2)(A). Therefore, the court decided that collateral estoppel applied to the state court judgment and precluded relitigation of the issue under section 523(a)(2)(A).

This case is analogous to Diamond. The elements of fraud under Hawaii state law are identical in substance to the elements of fraud under section 523(a)(2). The state court necessarily concluded that each of the required elements of fraud were met under state law. This precludes the relitigation of the identical issues of fraud under section 523(a)(2)(A).

C. Section 523(a)(6)

The plaintiffs allege that the Debtor's debts to the plaintiffs are not dischargeable pursuant to section 523(a)(6) because the state court entered judgments against the Debtor for intentional misconduct and such intentional misconduct satisfies the requirements of "willful and malicious injury."

Section 523(a)(6) provides:

> (a) A discharge under section 727 . . . of this title does not discharge an individual debtor from any debt–
>
> . . . .
>
> (6) for willful and malicious injury by the debtor to another entity or to the property of another entity;

The willful injury requirement is met only when the debtor subjectively intends to inflict injury or when the debtor subjectively believes that injury is substantially certain to result from his own conduct. In re Su, 290 F.3d 1140 (9th Cir. 2002); see also In re Jercich, 238 F.3d 1202, 1209 (9th Cir. 2001), cert. denied, 533 U.S. 930 (2001).

In Diamond, supra, the court also concluded that the state court judgment necessarily included the essential element of "willful and malicious" injury for the section 523(a)(6) claim because "[i]n order to find fraud, the jury had to determine that there was intentional tortious conduct." Id. at 828. Thus,

the issues implicated by the section 523(a)(6) claim were actually litigated in the state court proceeding and the state court judgment was preclusive with regard to the section 523(a)(6) claim. Likewise, the state court judgments against the Debtor prelude him from relitigating the issue of "willful and malicious injury."

D. Section 523(a)(4)

The plaintiffs allege that the Debtor's debts to the plaintiffs are not dischargeable pursuant to section 523(a)(4) because the state court entered judgments against the Debtor for fraud and breach of fiduciary duty.

Section 523(a)(4) provides:

> (a) A discharge under section 727 . . . of this title does not discharge an individual debtor from any debt–
>
> . . . .
>
> (4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny;

The elements for a determination of nondischargeability under section 523(a)(4) are: (1) whether the debtor incurred the debt by committing fraud or defalcation, and (2) whether the fraud or defalcation was in relation to the debtor's fiduciary responsibility. Bugna v. McArthur (In re Bugna), 33 F.3d 1054 (9th Cir. 1994). General partners occupy a "fiduciary capacity" within the meaning of

section 523(a)(4). See Lewis v. Scott (In re Lewis), 97 F.3d 1182 (9th Cir. 1996) (fiduciary duties imposed on partners by Arizona case law satisfy the requirements of section 523(a)(4)); Ragsdale v. Haller, 780 F.2d 794, 478 (9th Cir. 1986) (debt incurred as a result of defalcation by a partner in a partnership under California law was nondischargeable); Haw. Rev. Stat. § 425-123.

The Debtor argues that plaintiffs failed to plead or prove the section 523(a)(4) claim because the amended complaint alleges only that the Debtor acted in a fiduciary capacity, and not that he committed defalcation, embezzlement or larceny. The Debtor's argument is misplaced because section 523(a)(4) requires that the plaintiffs prove either fraud or defalcation while acting in a fiduciary capacity, but need not show both. The state court found both fraud and breach of fiduciary duty. Based on the state court judgments, the elements for a determination of non-dischargeability under section 523(a)(4) are met because the Debtor incurred the debt by committing fraud and the fraud was in relation to the debtor's fiduciary responsibility as a general partner of KP and KEP. This precludes relitigation of the identical issues under section 523(a)(4).

E. Plaintiffs De Coito and Yang

The Debtor argues that three of the plaintiffs, Charles DeCoito, Lisa DeCoito, and Mitsue Yang, had no dealings with the Debtor. The Debtor argues that the plaintiffs failed to show how the reliance element for fraud is met because these three plaintiffs only dealt with Weimer.

The Debtor's argument is an impermissible collateral attack on the state court judgments. The state court judgments held the Debtor and Weimer jointly and severally liable to these plaintiffs for fraud. The bankruptcy court should not and will not second guess the state court.

F. Plaintiffs Choy and Lum

The Debtor argues that two of the plaintiffs, Geraldine Choy and Maxine Lum, do not have a judgment against him and that a decision in his favor should be entered as to these two plaintiffs. Milton Choy and Norman Lum were plaintiffs in the state court cases, but they are now deceased. The amended complaint names their widows, Geraldine Choy and Maxine Lum, as plaintiffs in an unspecified representative capacity.

Rule 9 of the Federal Rules of Civil Procedure, made applicable by Fed. R. Bankr. P. 7009, provides that the defense of lack of capacity to sue must

be raised "by specific negative averment". Rule 12, as applicable by Fed. R. Bankr. P. 7012, provides that every defense must be raised in the responsive pleading or by motion before pleading. With the exception of a few specified defenses, any defense not so raised is deemed to have been waived. See Summers v. Interstate Tractor and Equipment Co., 466 F.2d 42 (9th Cir. 1972) (defendants did not raise the defense of plaintiff's capacity to sue by specific negative averment in its answer and the defense has been waived); Eckel v. Narciso (In Re Narciso), 149 B.R. 917 (E.D. Ark. 1993) (the failure of the defendants to raise the issue of plaintiff's capacity to sue in their pleadings constitutes a waiver of the defense).

The complaint was filed on January 1, 2000. The Debtor failed to raise the defense in his answer filed August 1, 2000. The Debtor first raised the issue in his motion for summary judgment filed April 6, 2001, in which he questions whether Plaintiffs Geraldine Choy and Maxine Lum are proceeding in a representative capacity. After the plaintiffs filed an amended complaint stating that Geraldine Choy and Maxine Lum were serving in a representative capacity, the Debtor filed an answer to the amended complaint on August 6, 2001, that again failed to raise the defense. The Debtor also did not raise the defense in his pretrial memorandum.

At trial on September 23, 2002, the Debtor orally objected to the standing of plaintiffs Geraldine Choy and Maxine Lum. Since the Debtor did not raise the defense of the plaintiffs' capacity to sue by specific negative averment in either of his answers, the argument of standing is untimely and the Debtor has waived that defense.[4]

IV. CONCLUSION

The debts owed to the plaintiffs by the Debtor are not dischargeable under sections 523(a)(2)(A), 523(a)(4), and 523(a)(6). An appropriate separate judgment will be entered.

DATED: Honolulu, Hawaii, JAN 10 2003.

Robert J. Faris
United States Bankruptcy Judge

[4] Even if the Debtor had not waived the defense, the appropriate remedy would be to amend the complaint to conform to the proof and enter judgment in favor of Milton Choy and Norman Lum. They are clearly entitled to judgment. The only question is whether their widows are entitled to judgment on their behalf.

JOY YANAGIDA, Esq.
MALUHIA PROFESSIONAL CENTER
33 MALUHIA DRIVE, SUITE 201
WAILUKU, HI 96793

STEVEN GUTTMAN, Esq.
19TH FLR., CENTRAL PACIFIC PZA.
220 SOUTH KING STREET
HONOLULU, HI 96813

BRADLEY R. TAMM, Esq.
828 FORT STREET MALL, STE. 330
HONOLULU, HI 96813

CERTIFICATION OF SERVICE
I HEREBY CERTIFY THAT THE ATTACHED ORDER/JUDGMENT WAS MAILED ON 1/10/03, TO THE ABOVE NAMED PARTIES IN INTEREST.

Joni Fukano
DEPUTY CLERK